

Report  
of the  
Examination of  
MGIC Credit Assurance Corporation  
Milwaukee, Wisconsin  
As of December 31, 2002

## TABLE OF CONTENTS

	Page
I. INTRODUCTION .....	2
II. HISTORY AND PLAN OF OPERATION .....	4
III. MANAGEMENT AND CONTROL .....	6
IV. AFFILIATED COMPANIES .....	8
V. REINSURANCE .....	18
VI. FINANCIAL DATA .....	19
VII. SUMMARY OF EXAMINATION RESULTS .....	29
VIII. CONCLUSION.....	30
IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS.....	31
X. ACKNOWLEDGMENT .....	32



# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

**Jim Doyle, Governor**  
**Jorge Gomez, Commissioner**

**Wisconsin.gov**

August 22, 2003

125 South Webster Street • P.O. Box 7873  
Madison, Wisconsin 53707-7873  
Phone: (608) 266-3585 • Fax: (608) 266-9935  
E-Mail: [information@oci.state.wi.us](mailto:information@oci.state.wi.us)  
Web Address: [oci.wi.gov](http://oci.wi.gov)

Honorable Alfred W. Gross  
Chairman, Financial Condition (E)  
Committee, NAIC  
Secretary, Southeastern Zone, NAIC  
Commissioner of Insurance  
Commonwealth of Virginia  
Tyler Building  
Post Office Box 1157  
Richmond, Virginia 23218

Honorable Sally McCarty  
Secretary, Midwestern Zone, NAIC  
Commissioner of Insurance  
State of Indiana  
311 West Washington St., Suite 300  
Indianapolis, Indiana 46204-2787

Honorable Jorge Gomez  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
Madison, Wisconsin 53702

Commissioners:

Honorable Susan F. Cogswell  
Secretary, Northeastern Zone, NAIC  
Commissioner of Insurance  
State of Connecticut  
153 Market St. 7th Floor  
Hartford, Connecticut 06103

Honorable John Morrison  
Secretary, Western Zone, NAIC  
Commissioner of Insurance  
State of Montana  
840 Helena Avenue  
Helena, Montana 59601

In accordance with the instructions of the Wisconsin Commissioner of Insurance (the  
“Commissioner”), a compliance examination has been made of the affairs and financial condition  
of:

MGIC CREDIT ASSURANCE CORPORATION  
Milwaukee, Wisconsin

and this report is respectfully submitted.

## I. INTRODUCTION

The previous examination of MGIC Credit Assurance Corporation ("MCAC," or the "company") was conducted in 1998 and 1999 as of December 31, 1997. The current examination covered the intervening period ending December 31, 2002, and included a review of such 2003 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain

documentation with respect to the alternative or additional examination steps performed during the course of the examination.

## **II. HISTORY AND PLAN OF OPERATION**

MGIC Credit Assurance Corporation was organized under the laws of Wisconsin on April 30, 1997, and commenced business on May 21, 1997. MCAC is a wholly owned subsidiary of Mortgage Guaranty Insurance Corporation ("MGIC").

The company was established by MGIC to serve as a direct writer of residential mortgage guaranty insurance on second mortgages and home equity lines of credit in a limited number of states. Concurrent with MGIC's establishment of MCAC, MGIC also established MGIC Assurance Corporation ("MAC") to engage in residential mortgage guaranty of junior liens accounted for through the MAC segregated account. Insurance laws in certain states do not allow a mortgage guaranty insurer to engage in any other line of insurance, even if accounted for through a segregated account, and MAC is unable to issue mortgage guaranty insurance in those states. MCAC was formed to write junior lien insurance in states that require a mortgage guaranty company to be a monoline insurer.

The company commenced writing direct business in 1998, and continued to issue new policies of mortgage guaranty insurance on junior liens through December 31, 2001. MCAC and MAC each terminated writing new business effective January 1, 2002. MCAC's current portfolio of insurance risks consists solely of renewal business on existing policies, and the company's entire book of business is in run-off. The company does not plan to resume writing new insurance risks. Subsequent to examination fieldwork, the Commissioner approved a plan proposed by MAC and MCAC to transfer the mortgage guaranty business of MAC's segregated account to MCAC.

MCAC is a member of a holding company system, and ultimate ownership and control of the company is held by MGIC Investment Corporation ("MGIC Investment"). MCAC does not have any employees, and all of its business operations are performed by MGIC pursuant to an intercompany services agreement. Further discussion of the MGIC Investment Corporation holding company, description of MCAC's significant affiliates, and description of the company's intercompany agreements are included in the section of this report captioned "Affiliated Companies."

In 2002, the company wrote direct premium in the following states:

<u>State</u>	<u>Premiums</u>	<u>Percentage</u>
Wisconsin	\$6,832,243	59.4%
California	4,656,810	40.5
New York	14,503	0.1
Illinois	<u>1,659</u>	<u>0.0</u>
	<u>\$11,505,215</u>	<u>100.0%</u>

The company is licensed in nineteen states and the District of Columbia.

In 2002, the company wrote \$11,505,215 of gross and net mortgage guaranty insurance premiums. The growth of the company through year-end 2001 and subsequent run-off through year-end 2002 is discussed in the Financial Data section of this report.

### III. MANAGEMENT AND CONTROL

#### Board of Directors

The MGIC Credit Assurance Corporation board of directors consists of seven members, each of whom is elected annually from within the senior executive management of MGIC Investment Corporation. MCAC directors are elected to serve a one-year term. Each member of the MCAC board of directors also serves as a member of other boards of directors in the holding company group, and receives no additional compensation for services performed as a director of MCAC.

Currently the MCAC board of directors consists of the following persons:

<b>Name and Residence</b>	<b>Principal Occupation</b>	<b>Term Expires</b>
Curt S. Culver Nashotah, WI	President and Chief Executive Officer MGIC Investment Corporation	2004
John D. Fisk Kensington, MD	Executive Vice President – Strategic Planning MGIC Investment Corporation	2004
Joseph J. Komanecki Delafield, WI	Senior Vice President, Controller and Chief Accounting Officer	2004
Jeffrey H. Lane Glendale, WI	Senior Vice President, General Counsel and Secretary MGIC Investment Corporation	2004
J. Michael Lauer Elm Grove, WI	Executive Vice President and Chief Financial Officer MGIC Investment Corporation	2004
Patrick Sinks River Hills, WI	Senior Vice President – Field Operations MGIC Investment Corporation	2004
Joseph J. Ziino, Jr. Brookfield, WI	Senior Vice President – Regulatory Relations, Associate General Counsel and Assistant Secretary MGIC Investment Corporation	2004



## **Officers of the Company**

MGIC Credit Assurance Corporation officers are appointed by the company's board of directors at the annual meeting of the board, and serve a one-year term of office. Senior officers serving at the time of this examination are listed below. Each MCAC officer is employed by MGIC, and a portion of the MGIC compensation costs for the respective MCAC officers is allocated to MCAC through an affiliated servicing agreement. The annual compensation paid to MCAC officers in 2002 is reported in the concurrent examination report of MGIC, under the caption "Officers of the Company."

<b>Name</b>	<b>Office</b>
Curt S. Culver	President and Chief Operating Officer
John D. Fisk	Executive Vice President – Strategic Planning
J. Michael Lauer	Executive Vice President and Chief Financial Officer
James S. MacLeod	Executive Vice President – Field Operations
Lawrence J. Pierzchalski	Executive Vice President – Risk Management
Joseph J. Komanecki	Senior Vice President, Controller and Chief Accounting Officer
Jeffrey H. Lane	Senior Vice President, General Counsel and Assistant Secretary
Patrick Sinks	Senior Vice President – Field Operations
Joseph J. Ziino, Jr.	Senior Vice President – Regulatory Relations Associate General Counsel and Secretary
James A. Karpowicz	Vice President and Treasurer

## **Committees of the Board**

The MCAC bylaws allow for the formation of certain committees by the board of directors. The company had established one committee of the board at the time of the examination, listed below:

### **Securities Investment Committee**

J. Michael Lauer  
Joseph J. Komanecki  
Joseph J. Ziino, Jr.

#### IV. AFFILIATED COMPANIES

MGIC Credit Assurance Corporation is a member of a holding company system. The ultimate parent of the holding company system is MGIC Investment Corporation.

The following organizational chart depicts the relationships among the affiliates in the holding company group. Each respective subsidiary is a wholly owned affiliate within the MGIC enterprise except as noted otherwise. A brief description of the significant affiliates of MGIC Credit Assurance Corporation and a summary of significant affiliated agreements follows the organizational chart.

##### **Organizational Chart As of December 31, 2002**

- MGIC Investment Corporation
  - Mortgage Guaranty Insurance Corporation
    - MGIC Reinsurance Corporation of Wisconsin
      - MGIC Mortgage Insurance Corporation
        - MGIC Mortgage and Consumer Asset II LLC (Note #1)
  - MGIC Credit Assurance Corporation
  - MGIC Assurance Corporation
    - MGIC Assurance Corporation Segregated Account
  - MGIC Reinsurance Corporation of Vermont
  - GHR Systems, Inc. (12% ownership interest)
  - MGIC Indemnity Corporation
  - eMagic.com
  - Sherman Financial Group LLC (45.5% ownership interest)
  - Equix Financial Services LLC (70.5% ownership interest)
  - MGIC Mortgage and Consumer Asset I LLC (Note #1)
    - CMI Investors LP 5 (99% ownership interest)
    - CMI Investors LP 8 (99% ownership interest)
    - CMI Investors LP 9 (99% ownership interest) )
    - CMI Investors LP 2 (99% ownership interest)
    - Credit-Based Asset Servicing & Securitization LLC (45.9% ownership interest)
    - Litton Loan Servicing LP
- MGIC Reinsurance Corporation
- MGIC Mortgage Reinsurance Corporation
- MGIC Residential Reinsurance Corporation
- MGIC Mortgage Marketing Corporation
- MGIC Investor Services Corporation
- MGIC Insurance Services Corporation
- MGIC Mortgage Securities Corporation
- MGIC OneStop Holdings LLC
  - OneStop Shop, Inc. (24% ownership interest)

Note # 1: MGIC Mortgage and Consumer Asset II LLC holds a 1% ownership interest in CMI Investors LP's; the remaining 99% interest is held in MGIC Mortgage and Consumer Asset I LLC.

**MGIC Investment Corporation (“MGIC Investment”)**

MGIC Investment was incorporated in Wisconsin on June 22, 1984 under the name Management Financing Corporation. MGIC Investment was established as a holding company to consolidate the ownership and capitalization of the legal entities within the MGIC enterprise. The initial capital funding of Management Financing Corporation was provided by The Northwestern Mutual Life Insurance Company and by senior executive officers of MGIC. The holding company name was changed to MGIC Investment Corporation effective March 1, 1985. An initial public offering of MGIC Investment common capital stock was completed in August of 1991, and a second public offering was completed in June 1992. The issued and outstanding shares of MGIC Investment common capital stock are traded on the New York Stock Exchange.

As of February 15, 2003, Legg Mason, Inc., an investment management company, held a 14.59% ownership interest in the outstanding MGIC Investment Corporation capital stock, and Janus Capital Management LLC held a 12.16% ownership interest in MGIC Investment. Officers and directors of MGIC Investment Corporation, who comprise 17 individual share holders, in aggregate held 1.26% ownership interest in MGIC Investment. Interests held by officers and directors included 31,085 share units held under MGIC Investment Corporation's directors' deferred compensation plan for which the holders currently do not have rights to exercise investment or voting power. Other investors, each of whom individually owned less than a 5% interest in MGIC Investment, held the remaining outstanding shares of MGIC Investment common capital stock.

The MGIC enterprise is principally engaged in writing mortgage guaranty insurance on residential mortgage loans. MGIC Investment Corporation insurance subsidiaries provide mortgage guaranty insurance to mortgage lenders, and its non-insurance operating subsidiaries provide products and services to the mortgage finance industry, including contract underwriting, mortgage portfolio analysis, secondary market mortgage brokerage and trading services, and internet-based technology services.

As of December 31, 2002, MGIC Investment's consolidated GAAP basis audited financial statements reported total assets of \$5,300,303,000, total liabilities of \$1,905,111,000,

and total shareholders' equity of \$3,395,192,000. Operations for 2002 provided reported net income of \$629,191,000.

### **Mortgage Guaranty Insurance Corporation ("MGIC")**

MGIC was incorporated under the laws of Wisconsin on February 20, 1979 as Liberty Mortgage Insurance Corporation ("LMIC"). LMIC was originally owned by Verex Corporation and was acquired by MGIC Investment Corporation in November 1984. The name Liberty Mortgage Insurance Corporation was changed to Mortgage Guaranty Insurance Corporation on March 1, 1985, when MGIC began writing new business.

MGIC formerly had two classes of issued and outstanding common capital stock, Class A common stock and Class B common stock. MGIC Investment Corporation retained ownership of the MGIC Class B common stock, and effective September 30, 1985 contributed 100% of the MGIC Class A common stock to the former MGIC Investment subsidiary Mortgage Guaranty Reinsurance Corporation ("MGRC"). Effective May 25, 1999, MGRC was dissolved pursuant to a plan of voluntary dissolution and liquidation approved by the Commissioner. Upon the dissolution of MGRC, all 35,000 issued and outstanding shares of MGIC Class B common stock held by MGIC Investment were redeemed at a price of \$1,000 per share, and the remaining assets and liabilities of the liquidated MGRC legal entity including 100% of the MGIC Class A common capital stock transferred to MGIC Investment Corporation. MGIC's capital stock presently is comprised solely of one class of common stock, wholly owned by MGIC Investment Corporation.

MGIC issues residential mortgage guaranty insurance in 50 states, the District of Columbia, Puerto Rico, and Bermuda. MGIC serves as the lead operating company in the MGIC group, and provides administrative and managerial services to its affiliates. MGIC's direct and indirect costs incurred in providing services to its affiliates are allocated to the respective affiliates pursuant to intercompany services agreements. Excess of loss insurance coverages on risks written by MGIC are ceded to four MGIC affiliate insurers to enable MGIC to comply with statutory restrictions in some states that limit an insurer's net retention of mortgage guaranty insurance for any one risk to not more than 25% of the total indebtedness to the insured.

As of December 31, 2002, MGIC's statutory financial statements reported total admitted assets of \$5,748,861,544, total liabilities of \$4,200,854,153, and policyholders' surplus of \$1,548,007,391. Operations for 2002 provided reported net income of \$256,475,739.

**MGIC Reinsurance Corporation of Wisconsin ("MRCW")**

MRCW was incorporated under the laws of Wisconsin on February 15, 1996, and commenced operations on April 1, 1996. MRCW was established to provide reinsurance to MGIC for primary and pool mortgage guaranty policy liabilities in excess of 25% of the total indebtedness to the insured, for mortgage guaranty policies written in all jurisdictions except six states. MRCW assumes all of its business from MGIC, and does not cede any business.

As of December 31, 2002, MRCW's statutory financial statements reported total admitted assets of \$648,397,711, total liabilities of \$200,721,132, and policyholder's surplus of \$447,676,579. Operations for 2002 provided reported net income of \$27,646,621.

**MGIC Mortgage Insurance Corporation ("MMIC")**

MMIC was incorporated under the laws of Wisconsin on April 30, 1987. MMIC was established to be an insurer that maintains a Standard and Poor's Corporation AAA claims paying ability rating, to provide the MGIC group with the facility to write mortgage guaranty insurance on loans that require the insurer to be rated AAA. MMIC assumes coverages issued by MGIC, and does not write any direct insurance business. MMIC has not assumed any new risks from MGIC for the past several years.

Prior to 1996, MMIC was a wholly owned subsidiary of MGIC. In 1996 MGIC contributed 100% of the common capital stock of MMIC to MGIC Reinsurance Corporation of Wisconsin.

As of December 31, 2002, MMIC's statutory financial statements reported total admitted assets of \$79,579,265, total liabilities of \$11,512,325, and policyholder's surplus of \$68,066,940. Operations for 2002 provided reported net income of \$4,535,872.

**MGIC Assurance Corporation ("MAC")**

MAC was organized under the laws of Oklahoma in 1937 under the name Insurers Indemnity and Insurance Company, and was subsequently renamed Financial Security

Assurance, Inc. of Oklahoma ("FSAOK"). FSAOK was acquired by MGIC in 1995, and effective November 18, 1996, MAC redomesticated to Wisconsin and adopted the name MGIC Assurance Corporation.

MAC established a segregated account in 1997 pursuant to the requirements of s. 611.24 (1), Wis. Statutes and s. Ins 3.09 (12)(g), Wis. Adm. Code, through which MAC is authorized to conduct junior lien guaranty insurance business. MAC commenced writing insurance on second mortgages and home equity lines of credit in 1997. MAC terminated writing new business effective January 1, 2002. MAC's current portfolio of insurance risks consists solely of renewal business on existing policies written through the segregated account, and MAC's entire book of business is in run-off.

In 1997, all of the issued and outstanding capital stock of MAC was contributed to the MGIC subsidiary insurer MGIC Surety Corporation ("Surety"). MGIC Surety Corporation was merged with and into MGIC effective November 30, 2002. Upon the merger of Surety, the assets and liabilities of MGIC Surety Corporation, including 100% of the issued and outstanding capital stock of MAC, transferred to MGIC.

As of December 31, 2002, MAC's statutory financial statements reported total admitted assets of \$35,284,592, total liabilities of \$12,516,380, and policyholder's surplus of \$22,768,212. Operations for 2002 produced net income of \$232,734.

#### **MGIC Reinsurance Corporation of Vermont ("MRCV")**

MRCV was established in December 1999 as a Vermont-domiciled insurer, to operate as a sponsored captive insurance company pursuant to Title 8, Chapter 141 of the State of Vermont Statutes. The Vermont Statutes permit a licensed insurer and participating sponsors to establish a sponsored captive reinsurance company to reinsure business written by the licensed insurer. MRCV reinsures MGIC mortgage guaranty risks on loans that were originated, purchased, or serviced by mortgage lenders which participate in MRCV captive reinsurance. For the business assumed by MRCV on behalf of a participating sponsor, MRCV establishes a protected cell account in which assets of each such participant are separately maintained and accounted for with respect to the participant's liabilities for mortgage guaranty risks assumed by

the participant. A separate participation agreement is established between MRCV and each respective participant. By establishing a participation agreement with MRCV, a lender which desires to engage in captive reinsurance is able to participate as a sponsored captive and is not required to establish a separate insurance or reinsurance legal entity. As of year-end 2002, MRCV had nine participation agreements in effect.

As of December 31, 2002, MRCV's statutory financial statements reported total admitted assets of \$3,971,536, including \$1.3 million of trust assets, total liabilities of \$1,073,387, and policyholder's surplus of \$2,898,149. Operations for 2002 produced net income of \$776,615.

### **MGIC Indemnity Corporation ("MIC")**

MGIC Indemnity Corporation is a Wisconsin-domiciled mortgage guaranty insurer originally incorporated in Wisconsin in 1956 under the name Mortgage Guaranty Insurance Corporation ("Old MGIC"). Old MGIC was a subsidiary of the former MGIC Investment Corporation ("Old MGIC Investment," the pre-1985 MGIC Investment Corporation). Ownership of Old MGIC Investment and its subsidiaries including Old MGIC was purchased by Baldwin-United Corporation ("Baldwin") in 1982. Baldwin became financially impaired in 1983 due in part to excess corporate debt, and filed petition for voluntary reorganization under Chapter 11 of the Federal Bankruptcy Code.

In 1984 the Commissioner approved a plan (the "Plan") whereby the ongoing successful business enterprise of Old MGIC could be protected from the bankruptcy of Baldwin and be continued in a successor legal entity. Pursuant to the Plan, effective February 28, 1985 the business operations of Old MGIC were transferred to a successor insurer named Mortgage Guaranty Insurance Corporation (the present-day MGIC), Old MGIC changed its name to Wisconsin Mortgage Assurance Corporation ("WMAC"), and WMAC entered into court-ordered liquidation proceedings under the supervision of the Commissioner.

Under the 1985 liquidation proceedings, WMAC discontinued issuance of new insurance business, its existing book of business entered run-off status managed by the present day MGIC, and 100% of WMAC's existing net retained liability for insurance risks was ceded to a group of international reinsurers under quota share reinsurance treaties. In December 1998, the

WMAC liquidation proceedings were terminated and WMAC entered rehabilitation proceedings. Mortgage Guaranty Insurance Corporation (the present-day MGIC) purchased WMAC as of December 31, 1998 under a plan of rehabilitation approved by the Commissioner. WMAC changed its name to MGIC Indemnity Corporation effective June 1, 2000. MIC has not written any new business since 1985, and its entire portfolio of business is comprised of renewal policies in run-off. All claims have been paid by WMAC or its reinsurers, and only a small amount of insurance inforce remains in run-off.

As of December 31, 2002, MIC's statutory financial statements reported total admitted assets of \$20,154,586, total liabilities of \$273,834, and policyholder's surplus of \$19,880,752. Operations for 2002 provided reported net income of \$646,092.

#### **eMagic.com, LLC ("eMagic")**

eMagic.com, LLC was organized in February 2000 to provide business-to-business interactive electronic services to the mortgage finance industry. eMagic products and services provide an internet technological facility to lenders, mortgage service providers, and other mortgage institutions, to access wholesaler/investor products and vendor services that pertain to the origination of mortgage loans.

As of December 31, 2002, eMagic.com, LLC's GAAP basis financial statements reported total admitted assets of \$1,753,000, total liabilities of \$1,148,000, and members' equity of \$604,000. Operations for 2002 resulted in a reported net loss of \$10,577,000.

#### **Credit-Based Asset Servicing & Securitization LLC ("C-BASS")**

C-BASS is a joint venture in which MGIC had a 45.9% ownership interest as of year-end 2002. The venture was formed in July 1996 to engage in the acquisition and resolution of delinquent or otherwise credit sensitive single family mortgage loans. C-BASS purchases, sells, and securitizes residential mortgage loans, seller-financed notes, mortgage-backed securities, and other asset-backed debt securities.

As of December 31, 2002, C-BASS's GAAP basis audited financial statements reported total assets of \$1,754,392,000, total liabilities of \$1,384,855,000, and owners' equity of \$369,537,000. Operations for 2002 provided reported net income of \$138,335,000.



**MGIC Reinsurance Corporation (“MGIC Re”)**

MGIC Re was incorporated under the laws of Wisconsin on February 21, 1985, and commenced business on March 1, 1985. MGIC Re was organized to provide the affiliated company MGIC with excess of loss reinsurance coverage. MGIC Re provides reinsurance to MGIC on primary and pool mortgage guaranty coverage in excess of 25% of the total indebtedness to the insured, on business written in six states. MGIC Re assumes all of its business from MGIC.

As of December 31, 2002, MGIC Re’s statutory financial statements reported total admitted assets of \$167,387,887, total liabilities of \$108,714,843, and policyholder’s surplus of \$58,673,044. Operations for 2002 provided reported net income of \$5,983,955.

**MGIC Mortgage Reinsurance Corporation (“MMRC”)**

MMRC was organized under the laws of Wisconsin on July 1, 1996, and commenced business activity on that date. MMRC was organized to provide the affiliated company MGIC with excess of loss reinsurance coverage. MMRC provides reinsurance to MGIC on mortgage guaranty primary and pool coverage in excess of 25% of the total indebtedness to the insured on business written in six states. MMRC’s reinsurance on any loan is limited to a maximum of 25% of the total indebtedness to the insured. MMRC assumes all of its business from MGIC, and does not cede any business.

As of December 31, 2002, MMRC’s statutory financial statements reported total admitted assets of \$16,101,360, total liabilities of \$2,088,409, and policyholder’s surplus of \$14,012,951. Operations for 2002 provided reported net income of \$1,159,246.

**MGIC Residential Reinsurance Corporation (“MRRC”)**

MRRC was organized under the laws of Wisconsin on July 1, 1996, and commenced business on that date. MRRC was organized to provide the affiliated company MGIC with excess of loss reinsurance coverage. MGIC Residential Reinsurance Corporation provides reinsurance to MGIC on mortgage guaranty primary and pool coverage in excess of 25% of the total indebtedness to the insured on business written in six states. MRRC reinsurance on any loan is

limited to a maximum of 25% the total indebtedness to the insured. MRRC assumes all of its business from MGIC and does not cede any of its business.

As of December 31, 2002, MRRC's statutory financial statements reported total admitted assets of \$15,925,334, total liabilities of \$2,070,188, and policyholder's surplus of \$13,855,146. Operations for 2002 provided reported net income of \$1,085,987.

### **Affiliated Agreements**

1. 1986 Tax Sharing Agreement – The MGIC enterprise maintains a Tax Sharing Agreement whereby MGIC Investment Corporation and specified subsidiaries that qualify under the Internal Revenue Code join in filing a consolidated federal income tax return. Tax benefit or liability attributed to each respective legal entity under the consolidated income tax return is based on the amount of benefit or liability that would otherwise be applicable if the respective legal entity filed a separate United States Corporation Income Tax Return. For purposes of income tax sharing, each subsidiary computes its own income on a separate company basis, and each computes its own respective taxes by applying on a separate company basis the provisions of the Internal Revenue Code. The Tax Sharing Agreement is amended from time-to-time as necessary to add or delete the participation of applicable affiliated entities, and currently provides that each of the Wisconsin-domiciled MGIC insurers is a participant in the agreement.
2. 1996 Servicing Agreement – MGIC maintains a Servicing Agreement under which MGIC performs management and administrative services for the benefit of various affiliates within the MGIC holding company. Services provided by MGIC to its affiliates include provision of office space and employees; administration of underwriting, risk management and claims; performance as agent for funds collection and disbursement; maintenance of investment portfolios and execution of investment transactions; maintenance of depository accounts; maintenance of books and records including financial records; and the preparation and delivery of reports, tax returns, and documents and filings as required. MGIC's direct costs and indirect expenses incurred in providing services to the individual affiliates are allocated to the respective affiliates. The Servicing Agreement is amended from time-to-time as necessary to add or delete the participation of applicable affiliated entities, and currently provides that each of the Wisconsin-domiciled MGIC insurers is a participant in the agreement.
3. MGIC – MCAC Net Worth Maintenance Agreement – Established effective February 11, 2000, the Net Worth Maintenance Agreement provides that, for the purpose of providing funds with which MCAC will be able to pay its insurance claims. MGIC agrees to contribute capital to MCAC to maintain minimum net worth of MCAC equal to eight and one-half percent of the risk in force of the aggregate outstanding MCAC insurance policies as of the end of each calendar quarter. MGIC's contributions toward the maintenance of MCAC net worth are subject to the maximum required contribution limitation of \$40 million for all contributions made by MGIC from December 1, 1999 until the termination of the agreement. Maximum contributions will be determined from time-to-time and all other additions by MGIC to the net worth of MCAC will reduce the remaining obligation of MGIC to make contributions up to the maximum contribution. The agreement is in effect for so long as there are any MCAC insurance policies in force, and in any event will terminate on December 31, 2010 if not terminated earlier. MGIC to-date has made capital contributions of \$20 million under the agreement. There were no capital contributions under the agreement in 2002.

4. MGIC – MCAC Capital Maintenance Agreements with respect to Arizona and Connecticut – MGIC has established agreements for the maintenance of MCAC capital as required for the licensure of MCAC in those two states. The agreement with regard to Arizona provides that MGIC will make any capital contribution to MCAC necessary to maintain MCAC capital and surplus of \$4 million, and is effective through September 30, 2004. The agreement with respect to Connecticut provides that MGIC will make any capital contribution to MCAC necessary to maintain MCAC capital and surplus of \$2 million until MCAC has three consecutive years of profitable operations, but in any event no later than April 1, 2006. MGIC to-date has not made capital contributions to MCAC under these agreements.

## **V. REINSURANCE**

MGIC Credit Assurance Corporation has not entered into any reinsurance treaties, and has not engaged in any reinsurance transactions for the assumption or cession of insurance risk.

## **VI. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported in the December 31, 2002, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System ("IRIS") ratio results for the period under examination, and the policyholder position calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

**MGIC Credit Assurance Corporation**  
**Assets**  
**As of December 31, 2002**

	<b>Assets</b>	<b>Nonadmitted Assets</b>	<b>Net Admitted Assets</b>
Bonds	\$33,087,468	\$ 0	\$33,087,468
Cash	1,761,144		1,761,144
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	529		529
Federal and foreign income tax recoverable and interest thereon	685,031		685,031
Interest, dividends, and real estate income due and accrued	524,655		524,655
Aggregate write-in for other than invested assets:			
Miscellaneous receivable	<u>61,424</u>	<u>          </u>	<u>61,424</u>
Total Assets	<u>\$36,120,251</u>	<u>\$ 0</u>	<u>\$36,120,251</u>

**MGIC Credit Assurance Corporation**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 2002**

Losses		\$12,892,415
Loss adjustment expenses		225,848
Payable to parent, subsidiaries, and affiliates		<u>1,797,284</u>
Total Liabilities		14,915,547
Common capital stock	\$ 3,000,000	
Gross paid in and contributed surplus	22,000,000	
Unassigned funds (surplus)	<u>(3,795,296)</u>	
Surplus as Regards Policyholders		<u>21,204,704</u>
Total Liabilities and Surplus		<u>\$36,120,251</u>

**MGIC Credit Assurance Corporation**  
**Summary of Operations**  
**For the Year 2002**

**Underwriting Income**

Premiums earned		\$11,505,215
-----------------	--	--------------

Deductions:

Losses incurred	\$20,852,815	
Loss expenses incurred	478,535	
Other underwriting expenses incurred	<u>1,073,945</u>	
Total underwriting deductions		<u>22,405,295</u>
Net underwriting loss		(10,900,080)

**Investment Income**

Net investment income earned	1,988,207	
Net realized capital gains	<u>260,961</u>	
Net investment gain		2,249,168

**Other Income**

Net loss from agents' or premium balances charged off		<u>(45)</u>
---	--	-------------

Net loss before federal and foreign income taxes		(8,650,957)
Federal and foreign income taxes incurred		<u>(3,077,000)</u>

Net loss		<u><u>\$(5,573,957)</u></u>
----------	--	-----------------------------



**MGIC Credit Assurance Corporation**  
**Cash Flow**  
**For the Year 2002**

Premiums collected net of reinsurance		\$11,504,805
Deduct:		
Loss and loss adjustment expenses paid (net of salvage or subrogation)	\$20,256,523	
Underwriting expenses paid	<u>1,190,613</u>	
Cash from underwriting		(9,942,331)
Net investment income		2,211,371
Other income (expenses):		
Agents' balances charged off		(45)
Deduct:		
Federal income taxes recovered		<u>3,366,756</u>
Net cash from operations		\$(4,364,249)
Proceeds from investments sold, matured, or repaid:		
Bonds	25,457,153	
Cost of investments acquired (long-term only):		
Bonds	<u>22,203,412</u>	
Net cash from investments		3,253,741
Cash provided from financing and miscellaneous sources:		
Net transfers from affiliates	833,286	
Total		
Cash applied for financing and miscellaneous uses:		
Other applications	<u>61,424</u>	
Net cash from financing and miscellaneous sources		<u>771,862</u>
Net change in cash and short-term investments		(338,646)
<b>Reconciliation</b>		
Cash and short-term investments, December 31, 2001		<u>2,099,790</u>
Cash and short-term investments, December 31, 2002		<u>\$1,761,144</u>

**MGIC Credit Assurance Corporation**  
**Policyholder Position Calculation**  
**December 31, 2002**

Surplus as regards policyholders		\$21,204,704
Net minimum policyholders' position		
Group of Loans:		
Equity less than 20%, or equity		
plus prior insurance or a		
deductible less than 25%	<u>\$9,601,656</u>	
Minimum policyholder position		<u>9,601,656</u>
Excess of total policyholders' position		
over minimum policyholders' position		<u>\$11,594,048</u>

**MGIC Credit Assurance Corporation**  
**Reconciliation and Analysis of Surplus**  
**For the Five-Year Period Ending December 31, 2002**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Surplus, beginning of year	\$5,158,577	\$5,483,250	\$7,955,833	\$16,853,377	\$26,732,661
Net income	324,673	472,583	897,544	(368,908)	(5,573,957)
Change in net deferred income tax				104,000	46,000
Cumulative effect of changes in accounting principles				144,192	
Capital changes:					
Paid in				1,000,000	
Surplus adjustments:					
Paid in		2,000,000	8,000,000	9,000,000	
Surplus, end of year	<u>\$5,483,250</u>	<u>\$7,955,833</u>	<u>\$16,853,377</u>	<u>\$26,732,661</u>	<u>\$21,204,704</u>

**MGIC Credit Assurance Corporation**  
**Insurance Regulatory Information System**  
**For the Five-Year Period Ending December 31, 2002**

The company's NAIC Insurance Regulatory Information System ("IRIS") results for the years under examination are summarized in the following table. The unusual IRIS results during the period are denoted with asterisks, and are discussed following the table of IRIS data.

	<b>Ratio</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
#1	Gross Premium to Surplus	0%	49%	53%	54%	54%
#2	Net Premium to Surplus	0%	49%	53%	54%	54%
#3	Change in Net Writings	0%	999%*	129% *	61% *	(20)%
#4	Surplus Aid to Surplus	0%	0%	0%	0%	0%
#5	Two-Year Overall Operating Ratio	0%	71%	82%	96%	137% *
#6	Investment Yield	7%	5%	6%	6%	(21)%
#7	Change in Surplus	6%	45%	112% *	59% *	(21)% *
#8	Liabilities to Liquid Assets	0%	26%	29%	34%	42%
#9	Agents' Balances to Surplus	0%	0%	0%	0%	0%
#10	One-Year Reserve Devel. to Surplus	0%	2%	5%	(7)%	5%
#11	Two-Year Reserve Devel. to Surplus	0%	0%	2%	1%	(7)%
#12	Estimated Current Reserve Def. To Surplus	0%	0%	0% *	(14)%	(22)%

IRIS ratio number 3 evaluates the year-to-year change in an insurer's net written premium. The company's unusual results in 2001, 2002, and 2002 were due to the start-up of company operations and annual growth of premiums written, as the company expanded its geographic territory and its policy issuance activities during the three-year period.

IRIS ratio number 5 evaluates the profitability of an insurance company, and equals an insurer's loss ratio plus its expense ratio minus its investment income ratio. The company's unusual result of 137% for ratio number 5 in 2002 was due to significant increases in losses

incurred in 2002, and decreased premiums written in 2002 that resulted from the company's decision to stop writing new business effective January 1, 2002.

IRIS ratio number 7 evaluates an insurer's year-to-year change in policyholder surplus. The company's unusual result for ratio number 7 in 2000 was due to a capital contribution of \$8 million paid to the company by MGIC. The unusual result in 2001 was due to MGIC contributions of \$1 million of paid in capital and \$9 million of paid in surplus. The unusual result in 2002 was due to net operating losses of \$5.6 million. The 2002 net loss was caused by a 20% decrease of premium revenue from the prior-year to \$11.5 million due to termination of writing new business and by a 34% increase in incurred losses to \$20.9 million due to unfavorable underwriting experience.

IRIS ratio number 12 evaluates the adequacy of an insurer's current reserves, including a factor for change in premium volume. The company's unusual result in 2000 arose from the company increasing its estimated loss reserves by \$3.7 million from the prior-year, an increase of 168%. The company strengthened its reserves in 2000 based on its increased business volume and corresponding increases in estimated losses.

#### **Growth and Run-off of MGIC Credit Assurance Corporation**

<b>Year</b>	<b>Admitted Assets</b>	<b>Liabilities</b>	<b>Surplus As Regards Policyholders</b>	<b>Net Income</b>
1998	\$ 5,496,686	\$ 13,436	\$ 5,483,250	\$324,673
1999	10,678,319	2,722,486	7,955,833	472,583
2000	23,792,642	6,939,265	16,853,377	897,544
2001	39,856,763	13,124,102	26,732,661	(368,908)
2002	36,120,251	14,915,547	21,204,704	(5,573,957)

  

<b>Year</b>	<b>Gross Premium Written</b>	<b>Net Premium Written</b>	<b>Premium Earned</b>	<b>Loss And LAE Ratio</b>	<b>Expense Ratio</b>	<b>Combined Ratio</b>
1998	\$2,218	\$2,218	\$2,218			
1999	3,877,130	3,877,130	3,877,130	75.3%	14.1%	89.4%
2000	8,872,949	8,872,949	8,872,949	95.0%	(1.0)%	94.0%
2001	14,319,641	14,319,641	14,319,641	110.2%	7.2%	117.4%
2002	11,505,215	11,505,215	11,505,215	185.4%	9.3%	194.7%

Annual net contingency reserve contributions, required due to annual changes in premiums written, are included in the expense ratio calculations reported above, and contributed to the expense ratios experienced by the company in the years under examination.

The company was first organized in 1997, and commenced direct writing of policies on insurance risks in 1998. The growth of written premium and premium revenues from 1998 through 2000 reflect startup and expansion of the company's policy issuance activities, whereas the 2002 decrease in premiums reflects the January 1, 2002 termination of writing new business. The increases in the loss and LAE ratios during the period under examination reflect the increasingly unfavorable loss experience of the company in the junior lien mortgage guaranty market segment. The company received paid in surplus contributions of \$2 million in 1999 and \$8 million in 2000, and received a paid in surplus contribution of \$9 million and paid in capital of \$1 million in 2001. The company had underwriting losses of \$2,489,381 in 2001 and \$10,900,080 in 2002, and had net operating losses of \$368,908 in 2001 and \$5,573,957 in 2002.

**Reconciliation of Surplus per Examination**

The examination did not make any reclassification of or adjustment to year-end balances reported by the company. The company's surplus as regards policyholders as of December 31, 2002 was \$21,204,704.

## **VII. SUMMARY OF EXAMINATION RESULTS**

### **Compliance with Prior Examination Report Recommendations**

There was one specific comment and recommendation in the previous examination report. Comment and recommendation contained in the previous examination report and actions taken by the company are as follows:

1. Management and Control—It is recommended that the company's board of directors review executive decisions made on behalf of the company by the parent corporation, and that the board exercise its responsibility to manage the company by taking action on those decisions, by resolution of the company's board of directors

Action — Compliance

### **Summary of Current Examination Results**

The current examination did not result in any findings of material exception, and did not result in any recommendations requiring company action or compliance.

## **VIII. CONCLUSION**

MGIC Credit Assurance Corporation was organized under the laws of Wisconsin on April 30, 1997, and commenced business on May 21, 1997. The company was established to write residential mortgage guaranty insurance on second mortgage and home equity lines of credit for lenders in states in which a mortgage guaranty insurer must be a monoline company. MCAC is a wholly owned subsidiary of Mortgage Guaranty Insurance Corporation, and is licensed in 19 states and the District of Columbia.

The company commenced direct writing of mortgage guaranty policies on junior liens in 1998, and continued to write new policies through year-end 2001. Effective January 1, 2002, the company discontinued writing insurance on new mortgage guaranty risks, and the company's current book of business is comprised solely of renewal premiums on existing policies. The company plans to run-off its existing insurance risks, and does not intend to resume writing new mortgage guaranty business. Subsequent to examination fieldwork, the Commissioner approved a plan proposed by MAC and MCAC to transfer the mortgage guaranty business of MAC's segregated account to MCAC.

The examination determined that the company is in compliance with the single recommendation that resulted from the previous examination of the company. The current examination did not result in any findings of material exception, and did not result in any reclassification of account balances or adjustment to surplus. As of December 31, 2002, the company reported net admitted assets of \$36,120,251, total liabilities of \$14,915,547, and total surplus as regards policyholders of \$21,204,704.



## **IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

The current examination did not result in any findings of material exception, and did not result in any recommendations requiring company action or compliance.

## **X. ACKNOWLEDGMENT**

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

<b>Name</b>	<b>Title</b>
Rebecca Easland	Insurance Financial Examiner
Ryan Hanson	Insurance Financial Examiner
Tom M. Janke	Insurance Financial Examiner
Russell Lamb	Insurance Financial Examiner
Randy Milquet	Insurance Financial Examiner—Advanced

Respectfully submitted,

Thomas E. Rust  
Examiner-in-Charge